

No. 10090

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**In the United States Circuit Court of Appeals  
for the Ninth Circuit**

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**SAMUEL POORMAN, JR., PETITIONER**

*v.*

**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT**

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**ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED  
STATES BOARD OF TAX APPEALS**

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**BRIEF FOR THE RESPONDENT**

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**SAMUEL O. CLARK, Jr.,**  
*Assistant Attorney General.*

**SEWALL KEY,  
GERALD L. WALLACE,  
MAMIE S. PRICE,**

*Special Assistants to the Attorney General.*

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**FILED**

**JUN 8 - 1917**

**PAUL P. O'BRIEN,**

**CLERK**



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### **OPINION BELOW**

The only previous opinion in this case is that of the Board of Tax Appeals (R. 25-32), which is reported in 45 B. T. A. 73.

### **JURISDICTION**

This petition for review (R. 33-37) involves federal income taxes for the year 1937. On March 27, 1940, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of \$708.92. (R. 9-12.) Within ninety days thereafter and on May 27, 1940, the taxpayer filed a petition with the Board of Tax Appeals for a redetermination of that deficiency under the provisions of Section 272 of the

Internal Revenue Code. (R. 3-8.) The decision of the Board of Tax Appeals sustaining the deficiency was entered September 16, 1941. (R. 32-33.) The case is brought to this Court by a petition for review filed December 5, 1941 (R. 33-39), pursuant to the provisions of Section 1141 and 1142 of the Internal Revenue Code.

#### QUESTION PRESENTED

Whether an amount received by the taxpayer from his employer upon the termination of the employment in 1937, was additional compensation for personal service and therefore includible in gross income under Section 22 (a) of the Revenue Act of 1936, or exempt as a gift under Section 22 (b) (3).

#### STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

##### SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, \* \* \*.

(b) *Exclusions from Gross Income*.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

\* \* \* \* \*

(3) *Gifts, bequests, and devises*.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

## STATEMENT

Petitioner is a resident of Los Angeles, Clifornia. He is an attorney at law, employed by the city of Los Angeles. For a period of about 17 years prior to January, 1937, he had been employed in the legal department of the Los Angeles Gas & Electric Corporation, the greater part of which time he had been engaged in defending the corporation in litigation instituted by the city of Los Angeles and the city of Pasadena. (R. 15-16.)

During 1935 negotiations were begun looking to the sale of the electric properties of the corporation to the city of Los Angeles. Final agreement was executed in October 1936, under which such properties were sold to the city as of January 31, 1937, for approximately \$46,000,000. In connection with the sale approximately 840 employees of the corporation, including the petitioner, were transferred to the Department of Water and Power of the city of Los Angeles. The petitioner did not enter the employ of the city until March 1, 1937. (R. 16.)

Petitioner's salary, which from 1929 forward had been \$1,000 a month, was paid in full at that rate by the Los Angeles Gas & Electric Corporation to and including January 31, 1937. (R. 16-17.)

In September, 1932, the corporation and several other public utility companies in southern California established a "Uniform Pension and Benefit Plan" for their employees. This plan provided that each participating employee should contribute, by payroll deduction, three percent of his current wages to be "used solely to pro-



vide a portion of his total retirement income." The company was to pay the entire balance of the net cost of the employees' retirement income and in addition provide and administer at its own expense the death and disability benefits. It was also provided that the companies' contributions, once made to these funds, must be used for employee benefit only and not diverted to any other purpose. (R. 17.)

Under this plan normal retirement age was 65 for men and 60 for women. The amount of the monthly pension was to be based on the wages and length of service. If an employee withdrew or was released from service prior to normal retirement age the amount of his contribution was to be returned to him. The minimum pension for those who completed 20 or more years of service by normal retirement date was to be \$45 per month. The death benefit was to be an amount equal to one year's wages, with a minimum of \$2,000 for full-time employees. Special provisions were also made for disability benefits and employee contributions were to cease during the period of disability. (R. 18-19.)

When it became obvious that the sale would be consummated and a number of the corporation's employees transferred, it was recognized that these employees were losing various rights in leaving the service of the corporation and that "severance of employment meant sacrifice of pension rights." (R. 20.) In consideration of this fact the officers of the corporation wanted to do something for the employees being transferred. After much discussion and study the corporation decided about December, 1936, to make a payment to each of the



transferred employees based upon his age, length of service with the company, and wages received during the period of employment. The "tax angle" was also taken into consideration and it was decided to make the payment in such a manner that it would be a proper deductible expense of the corporation in computing the net profit from the sale. It was determined that the words "additional compensation" would accurately describe the payments. (R. 20-21.)

Accordingly, about January 25, 1937, the Los Angeles Gas & Electric Corporation sent two letters to each of the employees being transferred. One letter, signed by the president and general manager of the corporation and addressed to "Employees about to be transferred from the service of our Company", contained the following statement (R. 21-22):

Arrangements have been made to grant you additional compensation in recognition of the value of your past services. The amount of this payment will be based upon your present attained age, your length of service with the Company, and the rates of wages received during your period of employment; but this extra compensation will not be paid to employees whose "employment date" is more recent than September 1, 1934. Checks will be mailed to you as soon as possible after our electric properties have passed to the City.

The other letter was addressed to the members of the Uniform Pension and Benefit Plan who were being transferred and informed them that their membership in the plan would cease with the termination of their

service with the corporation and that checks would be sent covering the amount of their contributions to the plan. (R. 22.)

Petitioner received these two letters sometime after January 25, 1937. On that date he was notified by the president of the corporation that he was to be transferred to the water and power department of the city. "In the course of this conversation" (R. 22), the president advised him arrangements had been made to give a bonus to the employees who were to be transferred.

About February 19, 1937, the petitioner received from the Los Angeles Gas & Electric Corporation a check for \$8,394.92, to which was attached a voucher reading as follows (R. 23):

Additional compensation for services to and including January 31, 1937, in accordance with the President's letter of January 25, 1937. No. 26, Total amount, \$8,491.34. Deductions, Federal O. A. B., \$20. State, U. I., \$76.42. Net amount, \$8,394.92 This statement constitutes a valuable record of your earnings and the contributions you have made toward future social security benefit We recommend that you keep it for your further reference. Los Angeles Gas & Electric Corporation, detachable for presenting for payment.

The payments made by the corporation to the transferred employees, aggregating \$475,546.32, were charged to a ledger account designated "Sale of Electric Properties, Suspense Account." (R. 23.) On the books of the corporation the payments to the employees were treated as an expense incurred in connection with the

sale of the electric properties. In the corporation's income tax return for 1937 these payments were treated in the same manner and were deducted from the amount received from the city in computing the net profit realized from the sale of the electric properties. (R. 23-24.)

No bonus or additional compensation was paid to the employees retained by the corporation. Neither the petitioner nor any of the employees transferred had anything to do with the sale of the electric properties. (R. 24.)

In his income tax return for 1937 the petitioner reported this payment of \$8,394.92 as a gift and non-taxable income other than interest. The Commissioner determined that the \$8,394.92 was additional compensation and added this amount to the net income shown in petitioner's tax return for 1937. (R. 24-25.)

The Board of Tax Appeals sustained the Commissioner's determination and entered its decision for deficiency for 1937 in the amount of \$708.92. (R. 32-33.) The case is brought to this Court on petition for review filed by the petitioner. (R. 33-37.)

#### SUMMARY OF ARGUMENT

One of the primary factors in determining whether a payment is a gift or compensation is the intention of the parties, particularly the intention of the payor. The facts in this case show compensation was intended. The payor called it additional compensation. The value of the employees' past services was the measuring rod determining the amount of payment. The payments

were deducted by the payor in its income tax return. The evidence shows it was a business transaction in which the corporation was recognizing, at least, a strong moral obligation to compensate the employees for loss of the benefits of the pension and benefit plan.

The determination of the Commissioner was correct and the petitioner had the burden of overcoming that presumption. The showing of an absence of a technical consideration is not sufficient; he must prove that a gift was intended. A technical legal consideration is not necessary since a payment may be compensation for services although made voluntarily and without legal obligation. There is no presumption in favor of a gift and the burden of proving it is upon the donee. Petitioner has failed to sustain that burden in this case.

All factors here to be considered lead to the conclusion the payment was compensation and not a gift. The decision of the Board should therefore be affirmed.

#### ARGUMENT

**The \$8,394.92 paid to the petitioner by the Los Angeles Gas & Electric Corporation in February, 1937, was additional compensation and not a gift within the meaning of the tax statutes**

Section 22 (a) of the Revenue Act of 1936, *supra*, provides that gross income includes "compensation for personal service, of whatever kind and in whatever form paid."

The only question in this case is whether the amount paid to the petitioner by his employer, the Los Angeles Gas & Electric Corporation, about February, 1937, was additional compensation subject to tax or was a gift specifically exempt from gross income under the statute.

Various factors have been considered by the courts in arriving at a determination of whether a payment is compensation for services or a gift, the particular facts in each case forming the basis for the court's conclusion.

One of the highly important and primary factors to be considered in each case is the *intention* of the parties, particularly that of the payor, gathered from the facts and circumstances surrounding the transaction. *Fisher v. Commissioner*, 59 F. (2d) 192 (C. C. A. 2d); *Botchford v. Commissioner*, 81 F. (2d) 914, 916 (C. C. A. 9th); *Bass v. Hawley*, 62 F. (2d) 721 (C. C. A. 5th); *Walker v. Commissioner*, 88 F. (2d) 61 (C. C. A. 1st); *Schumacher v. United States*, 55 F. (2d) 1007, 1010 (C. Cls.); *Willkie v. Commissioner*, decided May 12, 1942, by the Circuit Court of Appeals for the Sixth Circuit, not yet reported but found in 1942 C. C. H., Vol. 4, par. 9470.

The facts in the instant case definitely show that the payment to the petitioner here was intended by the corporation as additional compensation. Throughout the record it was referred to by the corporation, the payor, as "additional compensation". In January, 1937, letters were addressed to the employees who were to be transferred, and signed by the president, advising them that they would be granted "additional compensation in recognition of the value of your past services." (R. 21-22.) About February 19, 1937, the petitioner received from the Los Angeles Gas & Electric Corporation a check for \$8,394.92, to which was attached a voucher stating that it was additional compensation for services in accordance with the president's letter. This voucher



also showed deductions for federal old age benefits and state unemployment insurance, such as would be made in a regular salary payment. Nowhere in the official statements of the corporation does the word "gift" appear. It was not a gift in round figures, but compensation, figured down to the odd cents, the value of the employee's past service being the measuring rod for the amount of the payment made in each case. The payment to this petitioner was measured by his salary and length of service, in which aspect it had a direct relationship to the services performed. *Willkie v. Commissioner, supra*; *Levey v. Helvering*, 68 F. (2d) 401 (App. D. C.)

Another important factor in determining whether a payment to an employee was a gift or compensation for services, is whether the payor deducted it in making his income tax return. *Noel v. Parrott*, 15 F. (2d) 669 (C. C. A. 4th), certiorari denied, 273 U. S. 754; *Botchford v. Commissioner, supra*; *Fisher v. Commissioner, supra*; *Willkie v. Commissioner, supra*; *Lougee v. Commissioner*, 26 B. T. A. 23, affirmed 63 F. (2d) 112 (C. C. A. 1st). In its income tax return for 1937 the corporation in the instant case deducted the payments made to the employees who were transferred, as an expense in connection with the sale. This fact further shows that the corporation did not intend the payments here to be gifts.

Part of the benefit accruing to the employees during their period of employment, in addition to the actual salary received, was their rights under the uniform pension and benefit plan, to which the corporation was

contributing both money and services. The sums contributed by the corporation were to be used for the employees' benefit and for no other purpose. When it was found impossible to continue these rights and benefits for the employees in question, the corporation determined, after much study and consideration, to make a cash payment to these employees as additional compensation for past services. It was the opinion of the Board that the evidence indicated that the motive of the corporation for making the payments to these employees was to compensate them for loss of their rights under the uniform pension and benefit plan, or to enable the corporation to withdraw the funds which had been put up with the insurance company in connection with the plan.

The evidence definitely shows that it was a business transaction, involving about one-third of the corporation's employees, and that the corporation was recognizing, at least, its strong moral obligation to compensate these employees for loss of the benefits of the pension plan.

After consideration of all the facts and evidence before it, the Board held that the Commissioner was correct in his determination that the payment to the petitioner in this case constituted compensation for service. The determination of the Commissioner was presumptively correct, and the burden was upon the petitioner to overcome that presumption. *Welch v. Helvering*, 290 U. S. 111; *Buck v. Commissioner*, 83 F. (2d) 786, 788 (C. C. A. 9th); *H. Liebes & Co. v. Commissioner*, 90 F. (2d) 932 (C. C. A. 9th). The Board



held that the petitioner in this case had failed to sustain the burden resting upon him.

Petitioner emphasizes the language used by the president of the corporation in a casual conversation had with him prior to receipt of official notice of the payment here in question, in which conversation the president advised him he was to receive a "bonus". The courts have held that "a bonus is not a gift or gratuity but a sum paid for services or upon a consideration in addition to or in excess of that which would ordinarily be given." *Levey v. Helvering, supra*, p. 403; *Noel v. Parrott, supra*; *Schumacher v. United States, supra*.

Petitioner contends that inasmuch as he had been paid the full amount of his agreed salary the additional payment was without consideration. Even the lack of a technical consideration would not be sufficient to overcome the Commissioner's determination and the decision of the Board. The petitioner must show that the payment to him was intended to be and was in fact a gift.

Consideration in a technical legal sense is not necessary to constitute a payment compensation. It is settled law that a payment may be compensation for services although made voluntarily and within legal obligation. *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 730; *Fisher v. Commissioner, supra*; *Weagant v. Bowlers, supra*; *Willkie v. Commissioner, supra*; *Bass v. Hawley, supra*. This Court, in *Botchford v. Commissioner, supra*, quoted with approval (p. 916) from the *Fisher* case, as follows:

The doctrine that bonus payments and gratuitous "additional compensation" for past services may constitute taxable income had been frequently recognized in decisions of the lower federal courts and of the Board of Tax Appeals.

In view of the reasons shown by the corporation for making the payments in this case, the adjustment of payments according to past services and salaries, the statements contained in the letter from the corporation's president and in the voucher attached to the checks, the deduction of old age benefits and unemployment insurance from the checks by the corporation, and the deduction of the payments by the corporation in its income tax return, it is submitted the amount received by the petitioner was intended to be and was in fact additional compensation and not a gift.

In the *Botchford* case this Court also called attention to the principle that there is no presumption in favor of a gift, and the burden of proving it is upon the donee. The petitioner in this case has failed to sustain the burden of showing the payment made to him was a gift.

Petitioner relies principally upon the decision in the case of *Bogardus v. Commissioner*, 302 U. S. 34, in which the Court was divided in its opinion five to four. The decision in that case rested upon the particular facts there present. This was set out by the court in *Willkie v. Commissioner, supra*, as follows:

In reference to the *Bogardus* case, it should be borne in mind that it is unsafe to classify adjudicated cases upon any complex question of law and to extract from them rules of general application as the reasoning in such cases is often due

to their diversities. It is therefore wiser to decide each case upon its own peculiar state of facts as to do otherwise, leads us into the field of abstract reasoning. The *Bogardus* case illustrates the necessity of following this rule. It discusses numerous cases from the circuits and from the Court of Appeals of the District of Columbia, overrules none of them and leaves each as positive authority coextensive with the facts on which the opinion was founded.

In analyzing the situation in the *Bogardus* case, the Supreme Court first emphasized the fact that the recipients of the bounty there never were employees of the Unopco Corporation which made the payments. The Court further concluded the payments could not be treated as compensation in view of the *stipulated fact* that the disbursements were not made or intended to be made for any services rendered to the Unopco Corporation. The Court then stated that if the disbursements had been made by the Universal Company, the employer of the recipients, there might be ground for the inference that they were payments of additional compensation, referring at that point to *Noel v. Parrott, supra*. Further the payments in question in the *Bogardus* case were not deducted in the corporation's income tax return.

In the instant case the petitioner had been an employee of the corporation making the payment to him, and had rendered valuable services to that corporation over a long period. There is no evidence of any statement by the payor, or any stipulation that the payments here were not intended as compensation. On the con-

trary the evidence positively shows that they were intended by the corporation, and stated by it, to be compensation for services rendered. In further confirmation of this fact, the corporation here deducted the payments in its income tax return. It is therefore submitted that the petitioner has failed to bring his case within the facts controlling the decision in the *Bogardus* case.

Petitioner also relies on the cases of *Blair v. Rosseter*, 33 F. (2d) 286 (C. C. A. 9th), and *Jones v. Commissioner*, 31 F. (2d) 755 (C. C. A. 3d). In each of those cases it was found that a gift was definitely intended. In the *Rosseter* case this Court sustained the decision of the Board holding that the payment there was a gift, and pointed out that the payment was denominated as a "gift" throughout the records by both stockholders and directors. In the *Jones* case the court concluded that a gift was intended, since the evidence showed that it was determined that the directors could not *gratuitously* dispose of the corporation's assets, so the stockholders then stepped in and gratuitously made a gift (p. 756), "from their own pockets and not from the assets of the companies, \* \* \*."

Petitioner also cites some English cases in support of his contentions. In view of the many Federal decisions dealing with the question and the many differences between the Federal and the English tax laws, a discussion of those cases is not deemed necessary here.

All the factors to be considered in determining whether the payment in this case was a gift or compensation for past services lead to the conclusion that the

sum received by the petitioner constituted a part of his gross income for the tax year in question.

CONCLUSION

The decision of the Board is correct and it should be affirmed.

Respectfully submitted.

SAMUEL O. CLARK, Jr.,  
*Assistant Attorney General.*

SEWALL KEY,  
GERALD L. WALLACE,

MAMIE S. PRICE,  
*Special Assistants to the Attorney General.*

MAY 1942.